

The economic headwinds facing higher education post Covid-19 AUDE Conference, 12th April 2021 London Economics

Introduction



To discuss the economic challenges facing UK higher education after the Covid-19 pandemic, we will consider:



What is the current state of the economy and university finances?

2. What are the **potential economic and political threats** to universities' income?

1. What is the current state of the economy and university finances?



Where (we think) higher education institutions are now



- Obviously, the pandemic has resulted in heavy financial losses for higher education institutions.
- The loss in income from international students' fees, and from catering, conferences and events during the lockdown(s), and the additional costs of making campuses Covid-ready has put many HEIs – across the entire sector into deficit.
- About 1 in 6 institutions potentially _ have insufficient net current assets to cover deficits.
- Liquidity is also a potential problem. Roughly 1 in 3 institutions have less than 30 days of cash or cash equivalents on hand.

£20 million

average reduction in net cash inflow after finance costs (NCIF)

2018-19

2020-21 forecast

Net cash inflow from operating activities after finance costs, as % of income

6.7% 14 HEIS < 0% 32 HEIS < 4% -0.1% 64 HEIS < 0% 93 HEIS < 4%

NCA

Net current assets

19 HEIs

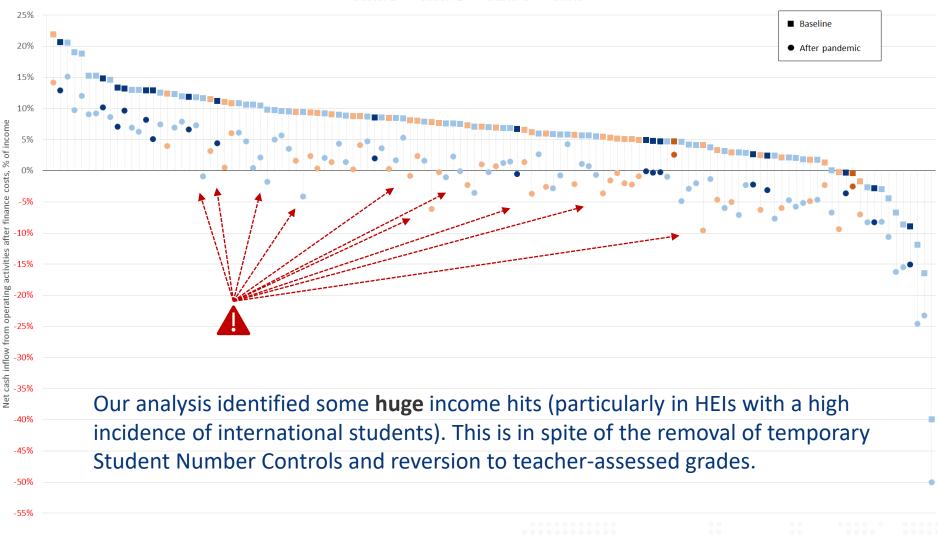
with NCA + NCIF < 0 (compared to 7 in 2018-19)



Where (we think) higher education institutions are now



Net cash inflow from operating activities after finance costs (NCIF)

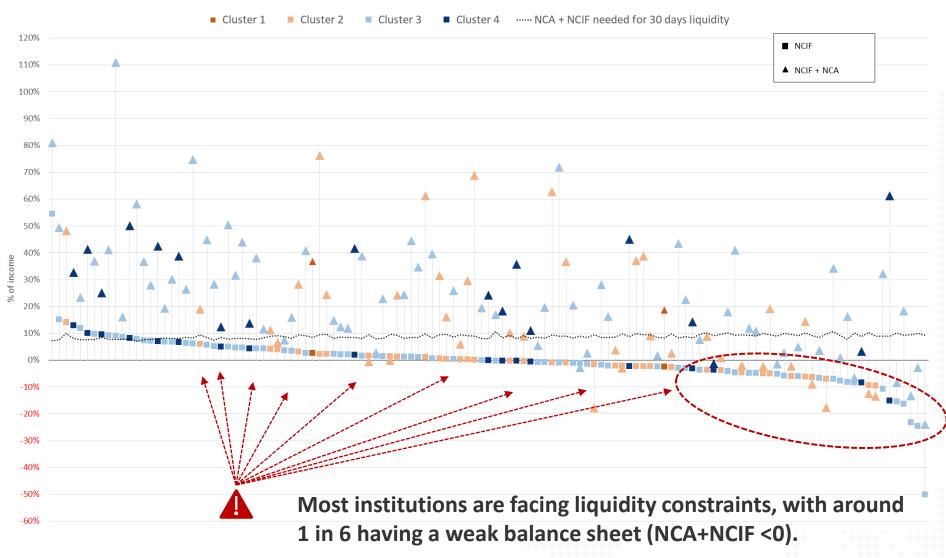


Cluster 1 Cluster 2 Cluster 3 Cluster 4

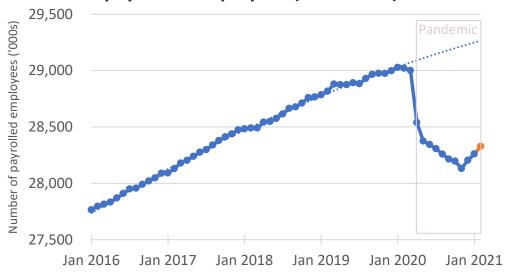
Where (we think) higher education institutions are now



Net current assets, NCIF and 30-day liquidity

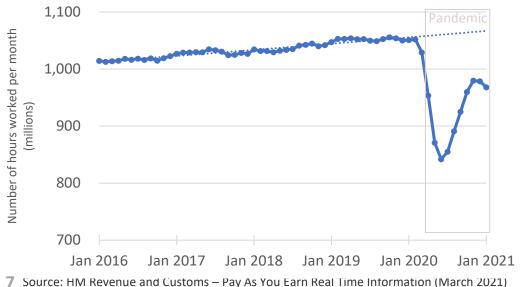


What's happening in the wider economy?



Number of payrolled employees (2016-2021)

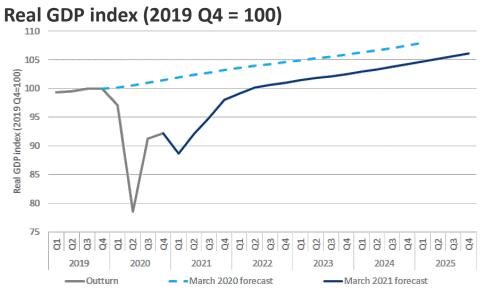
Number of hours worked (2016-2021)



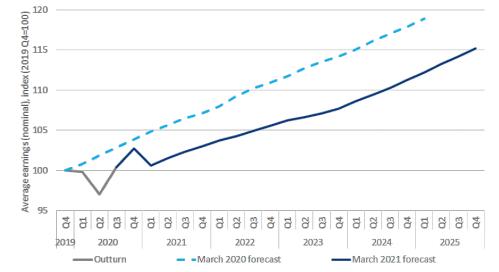


- There has been a decrease of 693,000 in payrolled employees since February 2020 (and more if you compare against where the economy might have been in the absence of the pandemic). This is approximately 2.4% lower than prepandemic levels.
- However, the impact is not being felt evenly. 63% of this decline is amongst people aged less than 25, and a further 25% is amongst 25-34 year olds.
- The number of hours worked was 210 million hours lower in June 2020 compared to February 2020 (a 20% decline), and is still 84 million hours a month lower than pre-pandemic levels (8%).
- Hours worked is important because it is highly correlated with the overall estimate of GDP growth.

What's happening in the wider economy?



Nominal average earnings index (2019 Q4 = 100)



Source: Office for Budget Responsibility, Economic and Fiscal Outlooks March 2020, November 2020, and March 2021

- Le London Economics
- In March 2020, the OBR estimated that real GDP would *increase* by 1.1% in 2020. Instead, it *dropped* by 9.9%.
- Following rapid growth during the economic recovery, real GDP is expected to recover to pre-pandemic levels in 2022.
- However, the effects of the pandemic will
- linger through **'scarring' effects**, lowering real GDP by **3%** in the medium term relative to its pre-pandemic path.
- Instead of 3.3% (March 2020 forecast), average earnings growth in 2020 stood at only 1.1% (in nominal terms). Earnings growth is expected to remain weak in the medium-term
- Again, the pandemic will have a 'scarring' effect, lowering average earnings by 6% relative to pre-pandemic forecasts.
- So what does all this mean for higher education?

2. What are the potential economic and political threats to universities' income?



Implications of low economic growth for HE finances

| Resource flows (£/£m/%) | Baseline | 'Low growth' |
|-------------------------------------|-------------|--------------|
| Exchequer | | |
| Cost of maintenance loan | (£4,019m) | (£4,208m) |
| Cost of tuition fee loan | (£5,395m) | (£5,650m) |
| Cost of teaching grants | (£1,242m) | (£1,242m) |
| Total Exchequer cost | (£10,656m) | (£11,100m) |
| RAB charge (%) | 53.9% | 56.3% |
| % never repaying full loan/anything | 88.2%/33.0% | 88.2%/33.0% |

Higher education institutions

| Gross fee income | £10,093m | |
|---------------------------|----------|---|
| Teaching Grant income | £1,242m | 2 |
| Cost of bursary provision | (£189m) | |
| Net HEI income | £11,147m | |

Students/Graduates (FT degrees)

| Average debt on graduation | £47,000 | £47,000 |
|-----------------------------------|-----------------|-----------------|
| Average lifetime repayments (M/F) | £34,800/£13,100 | £33,300/£12,000 |

Note: Estimates are based on English-domiciled UG students studying anywhere in the UK, and EU UG students studying in England. All monetary values have been discounted to net present values and are presented in constant 2020-21 prices. All values per student have been rounded to the nearest £100, and all totals have been rounded to the nearest £1m. Debt on graduation and expected lifetime repayments per student are presented for full-time undergraduate degree students only. Gross fee income refers to fee income before the deduction of fee bursaries provided to students

- Under the current funding system in 2020-21 (i.e. the Baseline), the Exchequer contributes approximately **£10.656bn** per cohort to the funding of (English) higher education (based on current economic forecasts).
- Since the RAB charge (i.e. the proportion of the loan balance written off) stands at approximately 53.9%, maintenance loan write-offs cost the Exchequer £4.019bn per cohort, while tuition fee loan write-offs cost £5.395bn. The provision of teaching grants to English HEIs (for high-cost subjects) results in additional costs of £1.242bn per cohort.
- The crucial measure is the RAB charge, which is (obviously) hugely dependent on graduate earnings. Based on *current* economic forecasts, due to the expected impact the Covid-19 pandemic on earnings growth, this has already increased from 43.5% to 53.9% in less than 2 years.
 - If real earnings growth is just **1 percentage point** lower for the next 10 years than *currently* expected, then this adds approximately **£444 million** to the Exchequer costs per cohort. This may have significant consequences for HEIs in terms of the 'generosity' of current teaching grant (or research funding) allocations.

What about more general policy changes?

- Fee reductions and rebates
 - There is significant pressure on HEIs to address students' concerns about providing any form of Covid-19 refund. Many institutions have provided accommodation refunds (when in their power to do so), but cash refunds are hugely expensive.
 - For example, a £500 per student refund would cost institutions approximately £500 million for UG students¹, and around £200 million for postgraduate² and Non-EU students³...

Augar Review (but this will surprise you!)

- The original analysis of the Augar Review's funding recommendations suggested that the full package of reforms would cost the Exchequer approximately £652 million a cohort (back in May 2019). However, a lot of this hinged on the RAB charge, which has increased from 43.5% to (a massive) 53.9% in less than 2 years. Perversely, the increase in the RAB charge is 'good' for HMT, because any conversion of loans to grants is now 'cheaper' (as there would be less to write off).
- Implementing the Augar recommendations in full would now *save* HMT £770 million a cohort (but whether HEIs are fully compensated for the proposed £1.8 billion in fee reductions through increased teaching grants is highly unlikely).

There are many others possible policy changes on the horizon...

- . English-domiciled undergraduate students studying anywhere in the UK and EU undergraduate students in England.
- 2. English-domiciled postgraduate students studying anywhere in the UK and EU postgraduate students in England.
- 3. Non-EU undergraduate and postgraduate students studying in England.



Allean

CONTRIBUTIONS

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Where do HEIs generate their income?



Total income of UK HEIs in 2018-19, £m

| Tuition Fee income | and education cont | racts (49%) | | | | C | other Services (| (19%) | |
|-----------------------------------|---|--|----------------------------------|-----------|---|----------|--|----------------------------------|--|
| | | | | | | <u>1</u> | ? / Other £2,48 | 36 | |
| | | | | | | C | atering, confer residences £ | | and |
| | | | Non-EU | fee incon | ne £5,793 | - | | Gov, | IK, UK/EU UK public £614 |
| JK fee income £11, | oc a | | EU fee i £1,1 | | Other cour fees and train grants £1,1 | ning |)ther £1,391 | Non teachi health/ £344 | ng EU (ex ′ _{LA} Gov.) 4 £270 |
| Research Grants an | | | | | Body Grants (| | uner £1,391 | | other other income (3%) |
| | UK charities, industry, other £1,253 | UK centra LAs/ NH credits £ | S/ Tax | | | | | | |
| Research Council income £2,167 | EU Gov, charities, industry, other £984 | Non-EU charities, industry, other £557 | UK industry/ other £444 | | grants (+OfS, I DfE) £2,499 | resea | search Englanc rch grants £2, al grants £515 | 319 | Investment, donations an endowment £1,230 |

- In 2018-19, UK HEIs generated approximately **£40.6bn** in income:
 - 49% from tuition fees (£20bn);
 - 13% from funding body grants (£5.3bn);
 - 16% from research grants and contacts (£6.6bn);
 - 19% from other services (£7.6bn); and
 - £1.2bn from investments/donations (3%).
- In 2019-20 and 2020-21, many of these income streams were very severely impacted by the Covid-19 pandemic (particularly international fee income and income from general operations (e.g. catering and conference activities). General costs have also increased substantially as a result of making campuses Covid-19 safe.
- A significant proportion of institutions are likely to be operating in deficit, so what are the prospects post-pandemic, and how important are the different income streams?

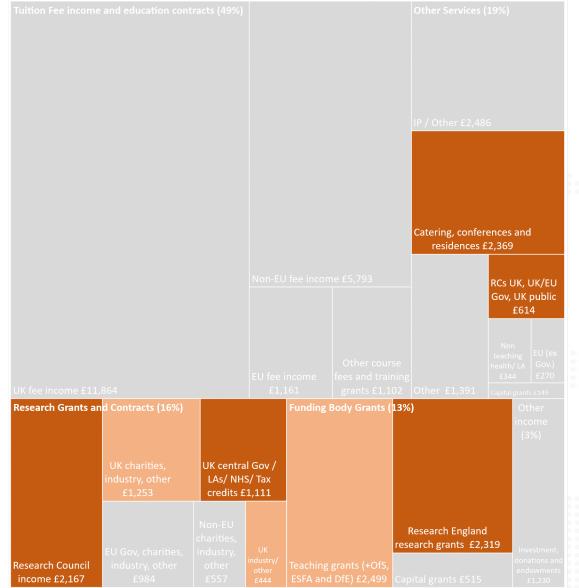
12 Source: Higher Education Statistics Agency (here).

What about research income and other UK public sector funding?



Total income of UK HEIs in 2018-19, £m

Source: Higher Education Statistics Agency (here).



- Given the likelihood that the UK government will attempt to identify cost savings, a large number of income streams will be under pressure – either directly or indirectly (at least 25% of income!).
- On top of announcements relating to the reduction of Overseas Development Aid (£0.125bn for UK HEIs):
 - There is already a suggestion that Horizon 2020 'access' charges might be paid for out of Research Council income (currently £2.17 bn); while
 - Income generated through central government departments/LAs/NHS (£1.11bn) is also likely to be under significant pressure.
 - This is on top of the significant pressure on teaching grant funding (from several directions).
- In addition, for most businesses, there will be very significant pressure to scale back expenditure and re-build balance sheets, putting pressure on **£444 million** of HEI income.

What about funding from international sources?



Total income of UK HEIs in 2018-19, £m

| | | | EU students: |
|---|---|--|--|
| | Non-EU fee income £5,793 | IP / Other £2,486 Catering, conferences and residences £2,369 RCs UK, UK/EU | Approximately 5% of undergraduate students and 10% of postgraduate students currently originate from the EU. Analysis undertaken for the Department for Education suggests that following the decoupling of fees and removal of student support, there will be a 45-55% reduction in the number of EU domiciled students. This is already apparent in a 40% reduction in UCAS applications data for 2021-22. This reduction will have a differential effect across the sector in terms of fee income – but teaching grant income will decline. |
| | | | |
| | | | Non-EU students: Although international demand remains |
| | Other course EU fee income fees and training £1,161 grants £1,102 | Non teaching EU (ex Fourthealth/LA 60000 6000 0ther £1,391 Capital grants £149 | relatively strong, there is increased competition from other jurisdictions Australia is back in |
| | Funding Body Grants (13% | | recruitment mode, while the US is reversing recent declines. |
| | | | EU-origin research funding: |
| | | | Any research related funding should be considered to be under very significant threat, |
| Non-EU charities EU Gov, charities, industry | | | and there is still a real question mark about the appetite of European institutions to partner with UK institutions, as well as the willingness |
| Research Councilindustry, otherotherincome £2,167£984£557 | | pital grants £515 £1,230 | of EU citizens to remain in the UK. |

14 Source: Higher Education Statistics Agency (here).

Conclusions – look away now!



Total income of UK HEIs in 2018-19, £m

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| escarcii Grants ai | | | | Funding | Douy Grants (| 1370) | | |
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| | | Non-EU | | | | Rese <u>arch En</u> | gland | |
| | Ell Goy charities | charities, | | | | Research En research grants | | |
| Research Council | EU Gov, charities, industry, other | | | | grants (+OfS, | | | |

- Depressingly, it's probably quicker to talk about HEI income streams that are not under threat...
- Importantly, the threats to HEI income will fall very unequally across the sector, but will likely impact research intensive institutions disproportionately. Smaller regional HEIs relying on less international students are likely to be more insulated.
- HEI assets might be overvalued.
- Brexit will mean that the composition of the student body is likely to change substantially.
- The pandemic will likely result in a **levelling up ... in costs incurred** (i.e. need to deliver F-2-F and online).
- A significant proportion of HEIs will face increased pressure to generate a surplus, as well as liquidity constraints.
- In addition to the economic headwinds and Covid-19, rather than alleviating the financial pressures facing the sector, the wider policy environment also poses a significant threat in itself.

Thank you – any questions?

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